

FSB Community Bankshares Inc  
Form 10-Q  
November 14, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2011

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 001-52751

FSB Community Bankshares, Inc.  
(Exact name of registrant as specified in its charter)

United States  
(State or other jurisdiction of  
incorporation or organization)

74-3164710  
(I.R.S. Employer  
Identification Number)

45 South Main Street, Fairport, New York  
(Address of Principal Executive Offices)

14450  
Zip Code

(585) 223-9080  
(Registrant's telephone number)

N/A  
(Former name or former address, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer	<input type="radio"/>	Accelerated filer	<input type="radio"/>
Non-accelerated filer	<input type="radio"/>	Smaller reporting company	<input checked="" type="radio"/>

(Do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

As of November 14, 2011 there were 1,785,000 shares of the Registrant’s common stock, par value \$0.10 per share, outstanding, 946,050 of which were held by FSB Community Bankshares, MHC, the Registrant’s mutual holding company.

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FSB Community Bankshares, Inc.  
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## Part I. Financial Information

## Item 1. Consolidated Financial Statements

## FSB COMMUNITY BANKSHARES, INC.

Consolidated Balance Sheets  
September 30, 2011 and December 31, 2010 (unaudited)  
(Dollars in thousands, except share data)

	September 30, 2011	December 31, 2010
Assets		
Cash and due from banks	\$733	\$561
Interest-earning demand deposits	11,092	7,273
Cash and Cash Equivalents	11,825	7,834
Securities available for sale	60,340	72,634
Securities held to maturity (fair value 2011 \$7,333; 2010 \$7,305)	7,096	7,183
Investment in FHLB stock	1,404	1,513
Loans held for sale	1,688	342
Loans receivable, net of allowance for loan losses (2011 \$406; 2010 \$384)	121,384	114,477
Bank owned life insurance	3,235	3,144
Accrued interest receivable	776	888
Premises and equipment, net	3,203	2,705
Prepaid FDIC premium	470	579
Other assets	1,142	1,108
Total Assets	\$212,563	\$212,407
Liabilities & Stockholders' Equity		
Deposits:		
Non-interest-bearing	\$4,092	\$3,705
Interest-bearing	160,386	158,701
Total Deposits	164,478	162,406
Borrowings	24,191	26,732
Advances from borrowers for taxes and insurance	975	1,926
Official bank checks	1,380	363
Other liabilities	650	488
Total Liabilities	191,674	191,915
Stockholders' Equity		
Preferred Stock- no par value- 1,000,000 shares authorized; no shares issued and outstanding	-	-
Common Stock- \$0.10 par value – 10,000,000 shares authorized; 1,785,000 shares issued and outstanding	179	179

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Additional paid-in-capital	7,265	7,269
Retained earnings	13,533	13,537
Accumulated other comprehensive income	446	67
Unearned ESOP shares – at cost	(534 )	(560 )
Total Stockholders' Equity	20,889	20,492
Total Liabilities and Stockholders' Equity	\$212,563	\$212,407

See accompanying notes to consolidated financial statements

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## FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Income  
 Three Months Ended September 30, 2011 and 2010 (unaudited)  
 (Dollars in thousands, except per share data)

	2011	2010
Interest and Dividend Income		
Loans	\$1,555	\$1,614
Securities – taxable	219	285
Securities – tax exempt	14	3
Mortgage-backed securities	195	218
Other	2	7
Total Interest and Dividend Income	1,985	2,127
Interest expense		
Deposits	456	590
Borrowings	223	293
Total Interest Expense	679	883
Net Interest Income	1,306	1,244
Provision for Loan Losses	7	8
Net Interest Income After Provision for Loan Losses	1,299	1,236
Other Income		
Service fees	53	56
Fee income	36	10
Realized gain on sale of securities	111	95
Increase in cash surrender value of bank owned life insurance	30	34
Realized gain on sale of loans	100	155
Mortgage fee income	70	59
Other	26	33
Total Other Income	426	442
Other Expense		
Salaries and employee benefits	983	894
Occupancy expense	192	151
Data processing costs	33	27
Advertising	44	39
Equipment expense	140	107
Electronic banking	24	22
Directors' fees	31	30
Mortgage fees and taxes	93	61
FDIC premium expense	(23	) 58
Other expense	187	168
Total Other Expenses	1,704	1,557

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Income Before Income Taxes	21	121
Provision (Benefit) for Income Taxes	(5 )	29
Net Income	\$26	\$92
Earnings per common share – basic and diluted	\$0.02	\$0.05

See accompanying notes to consolidated financial statements

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## FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Income  
 Nine months Ended September 30, 2011 and 2010 (unaudited)  
 (Dollars in thousands, except per share data)

	2011	2010
Interest and Dividend Income		
Loans	\$4,599	\$4,809
Securities – taxable	726	1,124
Securities – tax exempt	38	3
Mortgage-backed securities	650	634
Other	6	12
Total Interest and Dividend Income	6,019	6,582
Interest expense		
Deposits	1,422	1,978
Borrowings	676	973
Total Interest Expense	2,098	2,951
Net Interest Income	3,921	3,631
Provision for Loan Losses	22	14
Net Interest Income After Provision for Loan Losses	3,899	3,617
Other Income		
Service fees	141	173
Fee income	45	36
Realized gain on sale of securities	135	87
Realized loss on sale of real estate owned	-	(5
Increase in cash surrender value of bank owned life insurance	91	99
Realized gain on sale of loans	225	238
Mortgage fee income	166	141
Other	94	94
Total Other Income	897	863
Other Expense		
Salaries and employee benefits	2,666	2,308
Occupancy expense	548	450
Data processing costs	82	70
Advertising	141	133
Equipment expense	380	314
Electronic banking	70	59
Directors' fees	98	85
Mortgage fees and taxes	185	178
FDIC premium expense	121	174
Other expense	568	523
Total Other Expenses	4,859	4,294

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Income (Loss ) Before Income Taxes	(63	)	186
Provision (Benefit) for Income Taxes	(59	)	26
Net Income (Loss)	\$(4	)	\$160
Earnings (Loss) per common share – basic and diluted	\$(0.00	)	\$0.09

See accompanying notes to consolidated financial statements

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## FSB COMMUNITY BANKSHARES, INC.

Consolidated Statements of Stockholders' Equity  
 Nine months Ended September 30, 2011 and 2010 (unaudited)  
 (Dollars in thousands)

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Unearned ESOP Shares	Total
Balance – January 1, 2010	\$179	\$7,275	\$13,317	\$ 174	\$(595 )	\$20,350
Comprehensive income:						
Net income	-	-	160	-	-	160
Change in net unrealized gain on securities available for sale, net of reclassification adjustment and taxes	-	-	-	364	-	364
Total Comprehensive Income						524
ESOP shares committed to be released (2,624 shares)	-	(4 )	-	-	27	23
Balance – September 30, 2010	\$179	\$7,271	\$13,477	\$ 538	\$(568 )	\$20,897
Balance – January 1, 2011	\$179	\$7,269	\$13,537	\$ 67	\$(560 )	\$20,492
Comprehensive income:						
Net loss	-	-	(4 )	-	-	(4 )
Change in net unrealized gain on securities available for sale, net of reclassification adjustment and taxes	-	-	-	379	-	379
Total Comprehensive Income						375
ESOP shares committed to be released (2,624 shares)	-	(4 )	-	-	26	22
Balance – September 30, 2011	\$179	\$7,265	\$13,533	\$ 446	\$(534 )	\$20,889

See accompanying notes to consolidated financial statements

## FSB COMMUNITY BANKSHARES, INC.

## Consolidated Statements of Cash Flows

Nine months Ended September 30, 2011 and 2010 (unaudited)

(Dollars in thousands)

	2011		2010
<b>Cash Flows From Operating Activities</b>			
Net income (loss)	\$(4	)	\$160
Adjustments to reconcile net income (loss) to net cash provided by (used by) operating activities:			
Net amortization of premiums and discounts on investments	565		743
Gain on sale of securities available for sale	(135	)	(97
Loss on sale of securities held to maturity	-		10
Gain on sale of loans	(225	)	(238
Proceeds from loans sold	2,706		7,377
Loans originated for sale	(3,827	)	(7,834
Amortization of net deferred loan origination costs	8		23
Amortization of premium on FHLB advances	150		-
Depreciation and amortization	305		238
Provision for loan losses	22		14
Expense related to ESOP	22		23
Deferred income tax (benefit) expense	(75	)	1
Earnings on investment in bank owned life insurance	(91	)	(99
Decrease in accrued interest receivable	112		147
Decrease in prepaid FDIC premium	109		162
Decrease (increase) in other assets	(34	)	271
Decrease in other liabilities	43		29
Loss on sale of real estate owned	-		5
Net Cash Provided By (Used By) Operating Activities	(349	)	935
<b>Cash Flows From Investing Activities</b>			
Purchases of securities available for sale	(35,078	)	(80,230
Proceeds from maturities and calls of securities available for sale	38,108		71,800
Proceeds from sales of securities available for sale	3,024		3,188
Proceeds from principal paydowns on securities available for sale	6,394		5,494
Purchases of securities held to maturity	(434	)	(510
Proceeds from sales of securities held to maturity	-		686
Proceeds from principal paydowns on securities held to maturity	510		387
Net decrease (increase) in loans	(6,937	)	2,387
Redemption of FHLB stock	109		278
Proceeds from sales of foreclosed real estate	-		74
Purchase of premises and equipment	(803	)	(216
Net Cash Provided By Investing Activities	4,893		3,338
<b>Cash Flows From Financing Activities</b>			
Net increase in deposits	2,072		5,839
Proceeds from borrowings	4,000		13,238
Repayments on borrowings	(6,691	)	(19,028

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Net decrease in advances from borrowers for taxes and insurance	(951	)	(1,106	)
Net increase in official bank checks	1,017		1,449	
Net Cash Provided By (Used By) Financing Activities	(553	)	392	
Net Increase in Cash and Cash Equivalents	3,991		4,665	
Cash and Cash Equivalents- Beginning	7,834		5,965	
Cash and Cash Equivalents- Ending	\$11,825		\$10,630	
Supplementary Cash Flows Information				
Interest paid	\$2,108		\$3,002	
Income taxes paid	\$-		\$-	

See accompanying notes to consolidated financial statements

## Notes to Consolidated Financial Statements

### Note 1-Basis of Presentation

The accompanying unaudited consolidated financial statements of FSB Community Bankshares, Inc. and its wholly owned subsidiary Fairport Savings Bank (collectively, the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and the applicable instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes necessary for a complete presentation of consolidated financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses, the evaluation of other-than-temporary impairment of investment securities, and the valuation of deferred tax assets. For additional information and disclosures required under GAAP, reference is made to the Company’s Annual Report on Form 10-K for the period ended December 31, 2010 (the “Form 10-K”) filed with the Securities and Exchange Commission (“SEC”) on March 31, 2011.

The unaudited consolidated financial statements and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” should be read in conjunction with the Company’s audited consolidated financial statements for the year ended December 31, 2010, included in the Form 10-K filed with the SEC on March 31, 2011.

Operating results for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

The consolidated financial statements at September 30, 2011 and December 31, 2010 and for the three and nine months ended September 30, 2011 and 2010 include the accounts of the Company, Fairport Savings Bank (the “Bank”) and the Bank’s wholly-owned subsidiary, Oakleaf Services Corporation (“Oakleaf”). All inter-company balances and transactions have been eliminated in consolidation. Certain amounts from prior periods may have been reclassified, when necessary, to conform to current period presentation. Such reclassifications had no impact on net income (loss) or stockholders’ equity.

The Company has evaluated subsequent events through the date these consolidated financial statements were issued. On October 26, 2011 the Bank opened its fifth full service branch location in Perinton, NY.

### Note 2-Fair Value Measurement and Disclosure

Management uses its best judgment in estimating the fair value of the Company’s financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Company could have realized in a sale transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective reporting dates and have not been re-evaluated or updated for purposes of these consolidated financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each reporting date.



## Note 2--Fair Value Measurement and Disclosure (Continued)

A fair value hierarchy that prioritizes the inputs to valuation methods is used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported with little or no market activity).

An asset or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used are as follows at September 30, 2011 and at December 31, 2010:

September 30, 2011				
Securities Available for Sale: (In Thousands)	Total	Level 1	Level 2	Level 3
U.S. Government and agency obligations	\$ 27,042	\$ -	\$ 27,042	\$ -
Mortgage-backed securities - residential	29,779	-	29,779	-
SBA pools	3,519	-	3,519	-
Total Available for Sale Securities	\$ 60,340	\$ -	\$ 60,340	\$ -
December 31, 2010				
Securities Available for Sale: (In Thousands)	Total	Level 1	Level 2	Level 3
U.S. Government and agency obligations	\$ 39,336	\$ 8,014	\$ 31,322	\$ -
Mortgage-backed securities - residential	29,361	1,673	27,688	-
SBA pools	3,937	-	3,937	-
Total Available for Sale Securities	\$ 72,634	\$ 9,687	\$ 62,947	\$ -

There was one mortgage-backed security for \$1.7 million transferred out of level 1 securities available for sale to level 2 securities available for sale during the nine months ended September 30, 2011, as a result of the lack of availability of observable market data used in the securities' pricing obtained through independent pricing services or dealer



market participants. There were six U.S. Government and agency obligations for \$8.0 million called during the nine months ended September 30, 2011 that were measured as level 1 securities available for sale at December 31, 2010. No assets or liabilities have been measured on a non-recurring basis at or for the nine months ended September 30, 2011 or at or for the year ended December 31, 2010.

Accounting guidance requires disclosure of fair value information about financial instruments, whether or not recognized in the consolidated balance sheets, for which it is practicable to estimate that value. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the defined fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. Certain assets and liabilities are excluded from the disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

Note 2--Fair Value Measurement and Disclosure (Continued)

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments at September 30, 2011 and December 31, 2010:

Cash, Due from Banks, and Interest-Earning Demand Deposits

The carrying amounts of these assets approximate their fair values.

Investment Securities

The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level 1), or matrix pricing (Level 2), which is a mathematical technique used widely in the banking industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are based on observable market based assumptions (Level 3). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) are used to support fair values of certain Level 3 investments. The Company had no Level 3 investment securities at September 30, 2011 or at December 31, 2010.

Investment in FHLB Stock

The carrying value of Federal Home Loan Bank ("FHLB") stock approximates its fair value based on the restricted nature of the FHLB stock.

Loans

The fair values of loans held to maturity are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Mortgage loans held for sale in the secondary market are carried at the lower of cost or fair value. Separate determinations of fair value for residential and commercial loans are made on an aggregate basis. Fair value is determined based solely on the effect of changes in secondary market interest rates and yield requirements from the commitment date to the date of the financial statements. Realized gains and losses on sales are computed using the specific identification method.

Accrued Interest Receivable and Payable

The carrying amount of accrued interest receivable and payable approximates fair value.

Deposits

The fair values disclosed for demand deposits (e.g., NOW accounts, non-interest checking, regular savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts for variable-rate certificates of deposit approximate their fair values at the reporting date. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

## Note 2--Fair Value Measurement and Disclosure (Continued)

## Borrowings

The fair values of FHLB borrowings are estimated using discounted cash flow analyses, based on the quoted rates for new FHLB advances with similar credit risk characteristics, terms and remaining maturity.

## Off-Balance Sheet Instruments

The fair values for off-balance sheet financial instruments (lending commitments and lines of credit) are estimated using the fees currently charged to enter into similar agreements, taking into account market interest rates, the remaining terms and present credit worthiness of the counterparties. Such fees were not material at September 30, 2011 and December 31, 2010.

The carrying amounts and estimated fair values of the Company's financial instruments at September 30, 2011 and December 31, 2010 are as follows:

	September 30, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In Thousands)			
Financial assets:				
Cash and due from banks	\$733	\$733	\$561	\$561
Interest-earning demand deposits	11,092	11,092	7,273	7,273
Securities available for sale	60,340	60,340	72,634	72,634
Securities held to maturity	7,096	7,333	7,183	7,305
Investment in FHLB stock	1,404	1,404	1,513	1,513
Loans held for sale	1,688	1,688	342	342
Loans, net	121,384	128,473	114,477	116,350
Accrued interest receivable	776	776	888	888
Financial liabilities:				
Deposits	164,478	163,648	162,406	161,165
Borrowings	24,191	22,695	26,732	25,107
Accrued interest payable	58	58	68	68
Off-balance sheet instruments:				
Commitments to extend credit	-	-	-	-

## Note 3 - Securities

The amortized cost and estimated fair value of securities with gross unrealized gains and losses at September 30, 2011 and at December 31, 2010 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In Thousands)			
September 30, 2011:				
Available for Sale:				
U.S. Government and agency obligations	\$26,909	\$152	\$(19)	\$27,042
Mortgage-backed securities - residential	29,263	519	(3)	29,779
SBA pools	3,492	27	-	3,519
	\$59,664	\$698	\$(22)	\$60,340
Held to Maturity:				
Mortgage-backed securities-residential	\$4,405	\$162	\$-	\$4,567
State and Municipal securities	2,691	75	-	2,766
	\$7,096	\$237	\$-	\$7,333
December 31, 2010:				
Available for Sale:				
U.S. Government and agency obligations	\$39,764	\$32	\$(460)	\$39,336
Mortgage-backed securities - residential	28,882	539	(60)	29,361
SBA pools	3,886	51	-	3,937
	\$72,532	\$622	\$(520)	\$72,634
Held to Maturity:				
Mortgage-backed securities – residential	\$4,918	\$182	\$-	\$5,100
State and Municipal securities	2,265	-	(60)	2,205
	\$7,183	\$182	\$(60)	\$7,305

Mortgage-backed securities consist of securities that are issued by Fannie Mae (“FNMA”), Freddie Mac (“FHLMC”), Ginnie Mae (“GNMA”), and Federal Farm Credit Bank (“FFCB”) and are collateralized by residential mortgages.

The amortized cost and estimated fair value by contractual maturity of debt securities at September 30, 2011 are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations.

## Note 3 – Securities (continued)

	Available for Sale		Held to Maturity	
	Amortized Cost (In Thousands)	Estimated Fair Value (In Thousands)	Amortized Cost (In Thousands)	Estimated Fair Value (In Thousands)
Due in one year or less	\$-	\$-	\$-	\$-
Due after one year through five years	2,500	2,531	1,177	1,197
Due after five years through ten years	11,893	11,979	1,514	1,569
Due after ten years	12,516	12,532	-	-
Mortgage-backed securities – residential	29,263	29,779	4,405	4,567
SBA pools	3,492	3,519	-	-
	\$59,664	\$60,340	\$7,096	\$7,333

For the nine months ended September 30, 2011 there was a \$24,000 gross realized gain on sale of mortgage-backed securities available for sale resulting from proceeds of \$1.4 million and a \$111,000 gross realized gain on sale of U.S. government agency securities available for sale resulting from proceeds of \$1.6 million. For the nine months ended September 30, 2010 there was a \$10,000 gross realized loss on sale of mortgage-backed securities held to maturity resulting from proceeds of \$686,000, a \$2,000 gross realized gain on sale of FHLMC common stock available for sale resulting from proceeds of \$11,000, and a \$95,000 gross realized gain on sale of U.S. government agency securities available for sale resulting from proceeds of \$3.2 million. In accordance with accounting guidance, the Company was able to sell securities classified as held to maturity after the Company had already collected a substantial portion (at least 85%) of the principal outstanding at acquisition due either to prepayments or to scheduled principal and interest payments on the debt securities.

No securities were pledged to secure public deposits or for any other purpose required or permitted by law at September 30, 2011 or at December 31, 2010.

The following table shows gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at September 30, 2011 and December 31, 2010:

## Note 3 – Securities (continued)

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(In Thousands)					
September 30, 2011:						
Available for Sale						
U.S. Government and agency obligations	\$3,537	\$6	\$3,360	\$13	\$6,897	\$19
Mortgaged-backed securities - residential	2,144	3	-	-	2,144	3
Held to Maturity						
State and Municipal securities	-	-	-	-	-	-
	\$5,681	\$9	\$3,360	\$13	\$9,041	\$22
December 31, 2010:						
Available for Sale						
U.S. Government and agency obligations	\$24,757	\$460	\$-	\$-	\$24,757	\$460
Mortgaged-backed securities - residential	8,387	60	-	-	8,387	60
Held to Maturity						
State and Municipal securities	1,875	60	-	-	1,875	60
	\$35,019	\$580	\$-	\$-	\$35,019	\$580

Management evaluates securities for other-than-temporary impairment at least quarterly, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than the amortized cost basis, (2) the financial condition of the issuer (and guarantor, if any) and adverse conditions specifically related to the security, industry or geographic area, (3) failure of the issuer of the security to make scheduled interest or principal payments, (4) any changes to the rating of a security by a rating agency, (5) the presence of credit enhancements, if any, including the guarantee of the federal government or any of its agencies, and (6) whether the Company intends to sell or more likely than not be required to sell the debt securities. In the nine month period ended September 30, 2011 and the year ended December 31, 2010, the Company did not record an other-than-temporary impairment charge.

At September 30, 2011, four U.S. Government and agency securities and two mortgage-backed securities were in a continuous unrealized loss position for less than twelve months. At September 30, 2011, four U.S. Government agency securities were in a continuous unrealized loss position for twelve months or more. The U.S. Government and agency securities and mortgage-backed securities were issued by U.S. government sponsored agencies. All are paying in accordance with their terms with no deferrals of interest or defaults. Because the decline in fair value is attributable to changes in interest rates, not credit quality, and because management does not intend to sell and will more than

likely not be required to sell these securities prior to recovery or maturity, no declines are deemed to be other-than-temporary.



## Note 4 – Loans and The Allowance for Loan Losses

Net loans at September 30, 2011 and December 31, 2010 consist of the following:

	2011	2010
	(In Thousands)	
Real estate loans:		
Secured by one-to-four residential	\$ 107,804	\$ 102,295
Home equity lines of credit	9,073	8,900
Secured by multifamily residential	1,355	1,165
Construction	966	652
Commercial	2,143	1,395
Other	75	73
 Total Loans	 121,416	 114,480
 Net deferred loan origination costs	 374	 381
Allowance for loan losses	(406 )	(384 )
 Net Loans	 \$ 121,384	 \$ 114,477

An analysis of activity in the allowance for loan losses for the nine months ended September 30, 2011 and 2010 is as follows:

	2011	2010
Balance at January 1	\$ 384	\$ 368
Provision for loan losses	22	13
Loans charged-off	-	-
Recoveries	-	-
 Balance at September 30	 \$ 406	 \$ 381

The loan portfolio is segmented into commercial and consumer loans. Commercial loans consist of commercial real estate. Consumer loans consist of the following classes: residential real estate, construction, home equity lines of credit, and other consumer.

The Bank's primary lending activity is the origination of one-to-four residential real estate mortgage loans. At September 30, 2011, \$107.8 million, or 88.8%, of the total loan portfolio consisted of one-to-four residential real estate mortgage loans compared to \$102.3 million, or 89.4%, of the total loan portfolio at December 31, 2010. The Bank offers fixed-rate and adjustable-rate residential real estate mortgage loans with maturities of up to 30 years and maximum loan amounts generally of up to \$750,000.

The Bank currently offers fixed-rate conventional mortgage loans with terms of up to 30 years that are fully amortizing with monthly loan payments, and adjustable-rate mortgage loans that provide an initial fixed interest rate for one, three, five, seven or ten years and that amortize over a period of up to 30 years. The Bank originates fixed-rate mortgage loans with terms of less than 15 years, but at rates applicable to 15-year loans. The Bank originates fixed-rate bi-weekly mortgage loans with terms of up to 30 years that are fully amortizing with bi-weekly loan payments, and "interest only" loans where the borrower pays interest for an initial period (ten years) after which the loan

converts to a fully amortizing loan.

Note 4 – Loans and The Allowance for Loan Losses (continued)

Management actively monitors the interest rate risk position to determine the desired level of investment in fixed-rate mortgages. Depending on market interest rates and the Bank's capital and liquidity position, all newly originated longer term fixed-rate residential mortgage loans may be retained, or, all or a portion of such loans may be sold in the secondary mortgage market to government sponsored entities such as Freddie Mac or other purchasers.

The Bank originates residential, first mortgage loans with the assistance of computer-based underwriting engines licensed from Fannie Mae and/or Freddie Mac. Appraisals of real estate collateral are contracted directly with independent appraisers and not through appraisal management companies. The Bank's appraisal management policy and procedure is in accordance with all rules and best practice guidance from the Bank's primary regulator. Credit scoring, using FICO, is employed in the ultimate judgmental credit decision by the Bank's underwriting staff. The Bank does not use third party contract underwriting services. Residential mortgage loans include fixed and variable interest rate loans secured by one to four family homes generally located in Monroe, Ontario, and Wayne counties of New York State. The Bank's ability to be repaid on such loans is closely linked to the economic and real estate market conditions in this region. Underwriting policies generally adhere to Fannie Mae and Freddie Mac guidelines for loan requests of conforming and non-conforming amounts. In deciding whether to originate each residential mortgage, the Bank considers the qualifications of the borrower as well as the value of the underlying property.

Adjustable-rate mortgage loans generally present different credit risks than fixed-rate mortgage loans primarily because the underlying debt service payments of the borrowers increase as interest rates increase, thereby increasing the potential for default. Interest-only loans present different credit risks than fully amortizing loans, as the principal balance of the loan does not decrease during the interest-only period. As a result, the Bank's exposure to loss of principal in the event of default does not decrease during this period.

The Bank offers home equity lines of credit, which are primarily secured by a second mortgage on one-to-four-family residences. At September 30, 2011, home equity lines of credit totaled \$9.1 million, or 7.5%, of total loans receivable compared to \$8.9 million, or 7.7%, of total loans receivable at December 31, 2010.

The underwriting standards for home equity lines of credit include a determination of the applicant's credit history, an assessment of the applicant's ability to meet existing obligations, the value of the collateral securing the loan, and payments on the proposed loan. The combined loan-to-value ratio (first and second mortgage liens) for home equity lines of credit is generally limited to 90%. The Company originates home equity lines of credit without application fees or borrower-paid closing costs. Home equity lines of credit are offered with adjustable-rates of interest indexed to the prime rate, as reported in The Wall Street Journal.

Multi-family residential loans generally are secured by rental properties. Multi-family real estate loans are offered with fixed and adjustable interest rates. Loans secured by multi-family real estate totaled \$1.4 million, or 1.1%, of the total loan portfolio at September 30, 2011, compared to \$1.2 million, or 1.0%, of the total loan portfolio at December 31, 2010. Multi-family real estate loans are originated for terms of up to 20 years. Adjustable-rate multi-family real estate loans are tied to the average yield on U.S. Treasury securities, subject to periodic and lifetime limitations on interest rate changes.

Loans secured by multi-family real estate generally involve a greater degree of credit risk than one-to four-family residential mortgage loans and carry larger loan balances. This increased credit risk is a result of several factors including: the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by multi-family real estate typically depends upon the successful operation of the real estate property securing the loans. If the cash flow from the project is reduced, the borrower's

ability to repay the loan may be impaired.

Note 4 – Loans and The Allowance for Loan Losses (continued)

The Bank originates construction loans for the purchase of developed lots and for the construction of single-family residences. At September 30, 2011, construction loans totaled \$966,000, or 0.8%, of total loans receivable compared to \$652,000, or 0.6%, at December 31, 2010. At September 30, 2011, the additional unadvanced portion of these construction loans totaled \$299,000 compared to \$357,000 of additional unadvanced portion of construction loans at December 31, 2010. Construction loans are offered to individuals for the construction of their personal residences by a qualified builder.

Before making a commitment to fund a construction loan, we require an appraisal of the property by an independent licensed appraiser. We generally also review and inspect each property before disbursement of funds during the term of the construction loan.

Construction financing generally involves greater credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. If the estimate of construction cost proves to be inaccurate, we may be required to advance additional funds beyond the amount originally committed in order to protect the value of the property. Moreover, if the estimated value of the completed project proves to be inaccurate, the borrower may hold a property with a value that is insufficient to assure full repayment of the loan.

Commercial real estate loans are secured by office buildings, mixed use properties, places of worship, and other commercial properties. At September 30, 2011, \$2.1 million, or 1.7%, of our total loan portfolio consisted of commercial real estate loans compared to \$1.4 million, or 1.2%, of our total loan portfolio at December 31, 2010.

The Company generally originates adjustable-rate commercial real estate loans with maximum terms of up to 15 years. The maximum loan-to-value ratio of commercial real estate loans is 70%.

Loans secured by commercial real estate generally are larger than one-to-four-family residential loans and involve greater credit risk. Commercial real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate.

The Company offers a variety of other loans secured by property other than real estate. At September 30, 2011, these other loans totaled \$75,000, or 0.1%, of the total loan portfolio compared to other loans totaling \$73,000, or 0.1%, of the total loan portfolio at December 31, 2010. These loans include automobile, passbook, overdraft protection and unsecured loans. Due to the relative immateriality of other loans, the Company's risk associated with these loans is not considered significant.

## Note 4 – Loans and The Allowance for Loan Losses (continued)

The following table sets forth the allowance for loan losses allocated by loan class and the activity in our allowance for loan losses for the three months ended September 30, 2011. The allowance for loan losses allocated to each class is not necessarily indicative of future losses in any particular class and does not restrict the use of the allowance to absorb losses in other classes.

	Secured by 1-4 family residential	Secured by multifamily residential	Construction	Commercial	Home Equity	Other/ Unallocated	Total
(In thousands)							
Allowance for Loan Losses: Beginning Balance June 30, 2011	\$277	\$ 8	\$ 1	\$ 20	\$45	\$ 48	\$399
Charge Offs	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-
Provisions	6	2	4	1	3	(9 )	7
Ending Balance September 30, 2011 (1)	\$283	\$ 10	\$ 5	\$ 21	\$48	\$ 39	\$406

(1) All Loans are collectively evaluated for impairment.

The following table sets forth the allowance for loan losses allocated by loan class and the activity in our allowance for loan losses for the nine months ended September 30, 2011. The allowance for loan losses allocated to each class is not necessarily indicative of future losses in any particular class and does not restrict the use of the allowance to absorb losses in other classes.

	Secured by 1-4 family residential	Secured by multifamily residential	Construction	Commercial	Home Equity	Other/ Unallocated	Total
(In thousands)							
Allowance for Loan Losses: Beginning Balance December 31, 2010	\$242	\$ 9	\$ 3	\$ 14	\$55	\$ 61	\$384
Charge Offs	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-
Provisions	41	1	2	7	(7 )	(22 )	22
Ending Balance September 30, 2011 (1)	\$283	\$ 10	\$ 5	\$ 21	\$48	\$ 39	\$406

(1)All Loans are collectively evaluated for impairment.

The Bank's policies, consistent with regulatory guidelines, provide for the classification of loans that are considered to be of lesser quality as substandard, doubtful, or loss assets. An asset is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those assets characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets (or portions of assets) classified as loss are those considered uncollectible and of such little value that their continuance as assets is not warranted. Assets that do not expose us to risk sufficient to warrant classification in one of the aforementioned categories, but which possess potential weaknesses that deserve our close attention, are required to be designated as special mention. All other assets are categorized as pass.

## Note 4 – Loans and The Allowance for Loan Losses (continued)

When the Bank classifies assets as either pass, special mention, substandard, or doubtful, we allocate a portion of the related general loss allowances to such assets as we deem prudent. The allowance for loan losses is the amount estimated by management as necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the balance sheet date. Our determination as to the classification of our assets and the amount of our loss allowances are subject to review by the Bank's principal federal regulator, which prior to July 21, 2011 was the Office of Thrift Supervision and was succeeded by the Office of the Comptroller of the Currency (OCC), which can require that we establish additional loss allowances. We regularly review our asset portfolio to determine whether any assets require classification in accordance with applicable regulations.

At and for the nine and twelve months ended September 30, 2011 and December 31, 2010, respectively, there were no loans considered to be impaired. At September 30, 2011 and December 31, 2010 we had no troubled debt restructurings.

The following table presents the risk category of loans by class at September 30, 2011:

(In thousands)	Pass	Special Mention	Substandard	Doubtful	Total
One-to-four residential	\$ 107,426	-	\$ 378	-	\$ 107,804
Home equity lines of credit	9,049	-	24	-	9,073
Multi-family residential	1,355	-	-	-	1,355
Construction	966	-	-	-	966
Commercial	2,143	-	-	-	2,143
Other loans	75	-	-	-	75
Total	\$ 121,014	-	\$ 402	-	\$ 121,416

The following table presents the risk category of loans by class at December 31, 2010:

(In thousands)	Pass	Special Mention	Substandard	Doubtful	Total
One-to-four residential	\$ 102,238	-	\$ 57	-	\$ 102,295
Home equity lines of credit	8,784	-	116	-	8,900
Multi-family residential	1,165	-	-	-	1,165
Construction	652	-	-	-	652
Commercial	1,395	-	-	-	1,395
Other loans	73	-	-	-	73
Total	\$ 114,307	-	\$ 173	-	\$ 114,480

The Bank had \$325,000 in nonaccrual loans, comprised of one one-to-four residential property, and no foreclosed assets at September 30, 2011, and no nonaccrual loans or foreclosed assets at December 31, 2010. There were no loans that were past due 90 days or more and still accruing interest at September 30, 2011 and December 31, 2010. Interest on non-accrual loans that would have been earned if loans were accruing interest was \$18,093 for the nine months ended September 30, 2011 and \$1,176 for the nine months ended September 30, 2010.



## Note 4 – Loans and The Allowance for Loan Losses (continued)

Delinquent Loans. The following table sets forth an analysis of the age of the loan delinquencies by type and by amount past due as of September 30, 2011 and December 31, 2010.

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days (Dollars in thousands)	Total Past Due	Current	Total Loans Receivable
At September 30, 2011						
Real estate loans:						
One-to-four residential	\$-	\$53	\$325	\$378	\$107,426	\$107,804
Home equity lines of credit	24	-	-	24	9,049	9,073
Multi-family residential	-	-	-	-	1,355	1,355
Construction	-	-	-	-	966	966
Commercial	-	-	-	-	2,143	2,143
Other loans	-	-	-	-	75	75
Total	\$24	\$53	\$325	\$402	\$121,014	\$121,416
At December 31, 2010						
Real estate loans:						
One-to-four residential	\$57	\$-	\$-	\$57	\$102,238	\$102,295
Home equity lines of credit	116	-	-	116	8,784	8,900
Multi-family residential	-	-	-	-	1,165	1,165
Construction	-	-	-	-	652	652
Commercial	-	-	-	-	1,395	1,395
Other loans	-	-	-	-	73	73
Total	\$173	\$-	\$-	\$173	\$114,307	\$114,480

## Note 5 - Federal Home Loan Bank of New York Stock

Federal law requires a member institution of the Federal Home Loan Bank (FHLB) System to hold stock of its district FHLB according to a predetermined formula. This restricted stock is carried at cost.

Management evaluates the FHLB stock for impairment on a quarterly basis. Management's determination of whether this investment is impaired is based on its assessment of the ultimate recoverability of its cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB.

No impairment charges were recorded related to the FHLB stock for the nine month periods ended September 30, 2011 and 2010.

## Note 6 – Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the stockholders' equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects for the three and nine months ended September 30, 2011 and 2010 are as follows:

	For the Three Months Ended September 30, 2011		For the Nine months Ended September 30, 2011	
	2011	2010	2011	2010
	(In Thousands)		(In Thousands)	
Unrealized holding gain on available for sale securities	\$408	\$118	\$709	\$649
Reclassification adjustment for realized gain included in net income	(111)	(95)	(135)	(97)
Net Unrealized Gain	297	23	574	552
Tax effect	101	9	195	188
Net of tax amount	\$196	\$14	\$379	\$364

## Note 7 - Earnings Per Common Share

Basic earnings per common share are calculated by dividing net income by the weighted-average number of common shares outstanding during the period. The Company has not granted any restricted stock awards or stock options and had no potentially dilutive common stock equivalents. Unallocated common shares held by the ESOP are not included in the weighted-average number of common shares outstanding for purposes of calculating earnings per common share until they are committed to be released. The weighted average common shares outstanding were 1,731,646 for the three months ended September 30, 2011, 1,730,778 for the nine months ended September 30, 2011, 1,728,148 for the three months ended September 30, 2010 and 1,727,280 for the nine months ended September 30, 2010.

## Note 8 - Recent Accounting Pronouncements

## Accounting Standards Update No. 2011-05: Comprehensive Income (Topic 220) – Presentation of Comprehensive Income

The objective of this Update is to improve the comparability, consistency, and the transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. To increase the prominence of items reported in other comprehensive income and to facilitate convergence of U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS), the Financial Accounting Standards Board (FASB) decided to eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity, among other amendments in this Update.

The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and total of comprehensive income.

Note 8 - Recent Accounting Pronouncements (continued)

The amendments in this Update should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Management does not expect the adoption of this statement to have a material impact on the Company's consolidated financial statements.

Accounting Standards Update No. 2011-04: Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosures Requirements in U.S. GAAP and IFRS

The amendments of this Update are the result of work by the FASB and the International Accounting Standard Board (IASB) to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and IFRS. Consequently, the amendments change the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. The amendments include the following requirements:

Those that clarify the FASB's intent about the application of existing fair value measurement and disclosure requirements including:

- Application of the highest and best use and valuation premise concepts;
- Measuring the fair value of an instrument classified in a reporting entity's shareholders' equity; and
- Clarifying disclosure requirements of quantitative information about the unobservable inputs used in a fair value measurement that is categorized within Level 3 of the fair value hierarchy.

Those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements including:

- Measuring the fair value of financial instruments that are managed within a portfolio;
- Application of premiums and discounts in a fair value measurement; and
- Expanding disclosure requirements about Level 3 fair value measurements, use of nonfinancial assets in a way that differs from the asset's highest and best use and categorization by level of fair value hierarchy for items that are not measured at fair value in the statement of position but for which the fair value is required to be disclosed.

The amendments in this Update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after December 15, 2011. Management does not expect the adoption of this statement to have a material impact on the Company's consolidated financial statements.

Accounting Standard Update 2011-02: Receivables (Topic 310) – A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring

The FASB has issued this Update to clarify the accounting principles applied to loan modifications, as defined by FASB Accounting Standards Codification (ASC) Subtopic 310-40, Receivables – Troubled Debt Restructurings by Creditors. This guidance was prompted by the increased volume in loan modifications prompted by the recent economic downturn. The Update clarifies guidance on a creditor's evaluation of whether or not a concession has been granted, with an emphasis on evaluating all aspects of the modification rather than a focus on specific criteria, such as the effective interest rate test, to determine a concession. The Update goes on to provide guidance on specific types of modifications such as changes in the interest rate of the borrowing, and insignificant delays in payments, as well as guidance on the creditor's evaluation of whether or not a debtor is experiencing financial difficulties.

Note 8 - Recent Accounting Pronouncements (continued)

For public entities, the amendments in the Update are effective for the first interim or annual periods beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. The adoption of this statement did not have a material impact on the Company's consolidated financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

General

Throughout the Management's Discussion and Analysis ("MD&A"), the term "the Company" refers to the consolidated entity of FSB Community Bankshares, Inc., Fairport Savings Bank, and Oakleaf Services Corporation, a wholly owned subsidiary of Fairport Savings Bank. At September 30, 2011, FSB Community Bankshares, MHC the Company's mutual holding company parent, held 946,050 shares, or 53.0%, of the Company's common stock, engaged in no significant activities, and was not included in the consolidated financial statements or MD&A.

Forward Looking Statements

This Quarterly Report contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are subject to certain risks and uncertainties, including, among other things, changes in general economic conditions, either nationally or in our market areas, that are worse than expected; competition among depository and other financial institutions; inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments; adverse changes in the securities markets; changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements; our ability to enter new markets successfully and capitalize on growth opportunities; our ability to successfully integrate acquired entities, if any; changes in consumer spending, borrowing and savings habits; changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board; changes in our organization, compensation and benefit plans; changes in our financial condition or results of operations that reduce capital available to pay dividends; and changes in the financial condition or future prospects of issuers of securities that we own, that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. The Company wishes to advise readers that the factors listed above could affect the Company's financial performance and could cause the Company's actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements.

The Company does not undertake, and specifically declines any obligation, to publicly release the results of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Critical Accounting Policies

The most significant accounting policies followed by the Company are presented in Note 1 to the consolidated financial statements included in the Company's Annual Report filed on Form 10-K with the Securities and Exchange Commission on March 31, 2011. These policies, along with the disclosures presented in the other consolidated financial statement notes and in this discussion, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of consolidated financial statement amounts to the methods, assumptions and

estimates underlying those amounts, management has identified the determination of the allowance for loan losses, the evaluation of investment securities for other-than-temporary impairment and the valuation and recoverability of deferred tax assets to be the accounting areas that require the most subjective and complex judgments, and as such could be the most subject to revision as new information becomes available.

**Allowance for Loan Losses.** The allowance for loan losses is the amount estimated by management as necessary to absorb credit losses incurred in the loan portfolio that are both probable and reasonably estimable at the balance sheet date. The amount of the allowance is based on significant estimates, and the ultimate losses may vary from such estimates as more information becomes available or conditions change. The methodology for determining the allowance for loan losses is considered a critical accounting policy by management due to the high degree of judgment involved, the subjectivity of the assumptions used and the potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

As a substantial percentage of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans are critical in determining the amount of the allowance required for specific loans. Assumptions are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property securing a loan and the related allowance. Management carefully reviews the assumptions supporting such appraisals to determine that the resulting values reasonably reflect amounts realizable on the related loans.

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses. We consider a variety of factors in establishing this estimate including, but not limited to, current economic conditions, delinquency statistics, geographic concentrations, the adequacy of the underlying collateral, the financial strength of the borrower, results of internal loan reviews, and other relevant factors. This evaluation is inherently subjective as it requires material estimates by management that may be susceptible to significant change based on changes in economic and real estate market conditions. Various banking regulators, as an integral part of their examination process, also review the allowance for loan losses. Such regulators may require, based on their judgments about information available to them at the time of their examination, that certain loan balances be charged off or require that adjustments be made to the allowance for loan losses when their credit evaluations differ from those of management. Additionally, the allowance for loan losses is determined, in part, by the composition and size of the loan portfolio which represents the largest asset type on the consolidated balance sheet.

The evaluation has specific, general, and unallocated components. The specific component relates to loans that are classified as doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is generally established when the collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Actual loan losses may be significantly more than the allowance we have established which could have a material negative effect on our financial results.

**Other-than-temporary impairment.** When the fair value of a held to maturity or available for sale security is less than its amortized cost basis, an assessment is made at the balance sheet date as to whether other-than-temporary impairment (OTTI) is present.

The Company considers numerous factors when determining whether a potential OTTI exists and the period over which the debt security is expected to recover. The principal factors considered are (1) the length of time and the extent to which the fair value has been less than the amortized cost basis, (2) the financial condition of the issuer (and guarantor, if any) and adverse conditions specifically related to the security, industry or geographic area, (3) failure of the issuer of the security to make scheduled interest or principal payments, (4) any changes to the rating of a security by a rating agency, and (5) the presence of credit enhancements, if any, including the guarantee of the federal government or any of its agencies.





For debt securities, OTTI is considered to have occurred if (1) the Company intends to sell the security, (2) it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis, or (3) if the present value of expected cash flows is not sufficient to recover the entire amortized cost basis.

In determining whether OTTI has occurred for equity securities, the Company considers the applicable factors described above and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

For debt securities, credit-related OTTI is recognized in income while noncredit-related OTTI on securities not expected to be sold is recognized in other comprehensive income (loss). Credit-related OTTI is measured as the difference between the present value of an impaired security's expected cash flows and its amortized cost basis. Noncredit-related OTTI is measured as the difference between the fair value of the security and its amortized costs less any credit-related losses recognized. For securities classified as held to maturity, the amount of OTTI recognized in other comprehensive income (loss) is accreted to the credit-adjusted expected cash flow amounts of the securities over future periods. For equity securities, the entire amount of OTTI is recognized in income.

**Deferred Tax Assets.** Deferred tax assets and liabilities represent the future tax return consequences of temporary differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

#### Comparison of Financial Condition at September 30, 2011 and December 31, 2010

**Total Assets.** Total assets increased by \$156,000, or 0.1%, to \$212.6 million at September 30, 2011 from \$212.4 million at December 31, 2010. The modest increase in total assets primarily reflects increases in cash and cash equivalents, net loans receivable, loans held for sale, and premises and equipment, partially offset by decreases in securities available for sale, prepaid FDIC premium, accrued interest receivable and FHLB stock.

Total securities decreased by \$12.4 million, or 15.5%, to \$67.4 million at September 30, 2011 from \$79.8 million at December 31, 2010. The decrease in securities was a result of a \$12.3 million, or 16.9%, decrease in securities classified as available for sale to \$60.3 million at September 30, 2011 from \$72.6 million at December 31, 2010 and an \$87,000, or 1.2%, decrease in securities classified as held to maturity to \$7.1 million at September 30, 2011 from \$7.2 million at December 31, 2010. The \$12.3 million decrease in securities classified as available for sale was attributable to maturities and calls of \$38.1 million of U.S. government agency securities, \$2.9 million in sales of securities, and \$6.9 million in principal repayments received and amortization, partially offset by the purchase of \$27.0 million of U.S. government agency securities and \$8.0 million of mortgage-backed securities, and a \$574,000 increase in the fair value of securities classified as available for sale.

Securities classified as held to maturity decreased \$87,000 as a result of \$521,000 in principal repayments and amortization, partially offset by purchases of \$434,000 of State and Municipal bonds. All securities purchased in 2011, with the exception of State and Municipal bonds classified as held to maturity, have been classified as available for sale to provide a portfolio of marketable securities for liquidity as an alternative to borrowings. The Company has reviewed its investment securities portfolio for the nine months ended September 30, 2011, and has determined that no other-than-temporary impairment exists in the portfolio at September 30, 2011.



Net loans receivable increased \$6.9 million, or 6.0%, to \$121.4 million at September 30, 2011 from \$114.5 million at December 31, 2010. The Bank originated \$26.2 million of residential mortgage loans, sold \$3.8 million in the secondary market and brokered \$5.7 million of long-term fixed rate conventional mortgage loans and FHA mortgage loans as a balance sheet management strategy in the first nine months of 2011 to reduce interest rate risk in a potentially rising interest rate environment. The Bank sold these loans at a gain of \$225,000 which was recorded in other income in the first nine months of 2011. The Bank ended September 30, 2011 with \$17.8 million in mortgage loans sold and will realize servicing income on these loans as long as these loans have outstanding balances. In the current interest rate environment we intend to continue to sell a portion of our fixed-rate residential mortgage loans on a servicing-retained basis resulting in additional loan servicing income, as well as selling the majority of FHA mortgage loans originated on a servicing-released basis.

Cash and cash equivalents, primarily interest-earning deposits at the Federal Reserve Bank of New York and Federal Home Loan Bank of New York, increased by \$4.0 million, or 50.9%, to \$11.8 million at September 30, 2011 from \$7.8 million at December 31, 2010. The Bank continues to maintain a strong liquidity position, retaining excess cash and cash equivalent balances that will allow the Bank to capitalize on investment and lending opportunities that may arise in future periods.

Loans held for sale increased \$1.4 million, or 393.6%, to \$1.7 million at September 30, 2011 from \$342,000 at December 31, 2010. The \$1.7 million in loans held for sale at September 30, 2011 is comprised of FHA mortgage loans and fixed rate conventional loans originated and closed by the Bank in the third quarter of 2011 that have been committed for sale in the secondary market and will be delivered and sold in the fourth quarter of 2011.

The credit quality of the Bank's loan portfolio remains solid. At September 30, 2011 the Bank had net loans receivable of \$121.4 million, with \$325,000 in non-performing loans comprised of one one-to-four residential property compared to net loans receivable of \$114.5 million at December 31, 2010, with no non-performing loans. At September 30, 2011 and December 31, 2010 we had no foreclosed real estate owned or troubled debt restructurings. Management continues to actively monitor the performance of the loan portfolio during these difficult economic times. Credit quality continues to be the highest priority when underwriting loans. Subjective judgments about a borrower's ability to repay and the value of any underlying collateral are made prior to approving a loan. We believe our stringent underwriting standards have directly resulted in our significantly low level of non-accruing loans and non-performing loans.

Premises and equipment increased by \$498,000, or 18.4%, to \$3.2 million at September 30, 2011 from \$2.7 million at December 31, 2010. The increase was mainly due to the purchase of furniture and fixtures, office equipment, computer hardware, and building and leasehold improvements held in the construction in process account until the opening of the Perinton branch which opened in October 2011. Premises and equipment are recorded at cost and are generally depreciated by the straight-line method over the estimated useful lives of the assets. Furniture and equipment are generally depreciated over a useful life of three to seven years, and leasehold improvements over the shorter of the useful life or the term of the lease.

Prepaid FDIC premium decreased by \$109,000, or 18.8%, to \$470,000 at September 30, 2011 from \$579,000 at December 31, 2010. The Federal Deposit Insurance Corporation adopted a final rule pursuant to which all insured depository institutions were required to prepay their estimated assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012. Under the rule, this pre-payment of approximately \$793,000 to the Bank was due on December 31, 2009. We will continue to amortize this premium paid on a quarterly basis through December 31, 2012.

Accrued interest receivable decreased \$112,000, or 12.6%, to \$776,000 at September 30, 2011 from \$888,000 at December 31, 2010. The decrease was due primarily to a lower balance and lower yield in total securities at

September 30, 2011 compared to December 31, 2010.

Investment in FHLB stock decreased by \$109,000, or 7.2%, to \$1.4 million at September 30, 2011 from \$1.5 million at December 30, 2011 due to stock redemptions. The FHLB requires members to purchase and redeem stock based on the level of borrowings.

Liabilities. Total deposits increased by \$2.1 million, or 1.3%, to \$164.5 million at September 30, 2011 from \$162.4 million at December 31, 2010. The \$2.1 million increase consisted of core deposit growth of \$1.7 million including increases in non-interest bearing checking, interest-bearing checking, and savings accounts, and \$374,000 in non-core deposit growth consisting of IRA's and Certificates of Deposits. The Company's deposit costs have decreased as market interest rates have remained at historically low levels.

Official Bank checks increased \$1.0 million, or 280.2%, to \$1.4 million at September 30, 2011 from \$400,000 at December 31, 2010. The \$1.0 million increase is due to school tax bill checks outstanding at September 30, 2011.

Borrowings, consisting of Federal Home Loan Bank ("FHLB") advances, decreased by \$2.5 million, or 9.5%, to \$24.2 million at September 30, 2011 from \$26.7 million at December 31, 2010. The decrease of \$2.5 million in the first nine months of 2011 included \$6.7 million in maturities and principal payments of FHLB fixed rate borrowings, \$4.0 million in new FHLB fixed rate borrowings, and \$150,000 in amortization of deferred premium expense.

In July 2010, the Company restructured a portion of its FHLB advances by repaying \$13.2 million of existing borrowings and replacing these borrowings with \$13.2 million of new, lower cost FHLB advances. This transaction resulted in \$638,000 in prepayment penalties that have been deferred and are recognized in interest expense as an adjustment to the cost of the Company's new borrowings in future periods. At September 30, 2011 there was \$397,000 remaining in deferred premium expense on total FHLB borrowings.

Stockholders' Equity. Total stockholders' equity increased by \$397,000, or 1.9%, to \$20.9 million at September 30, 2011 from \$20.5 million at December 31, 2010. There was an increase of \$379,000 in accumulated other comprehensive income, and a \$22,000 increase in committed ESOP shares, partially offset by a net loss of \$4,000. At September 30, 2011 the Bank was considered well capitalized, which is the highest standard of capital rating as defined by the Bank's regulators.

Non-Performing Assets. At September 30, 2011 the Company had \$325,000 in loans classified as non-performing compared to no loans classified as non-performing at December 31, 2010. For both periods ended September 30, 2011 and December 31, 2010 the Company had no foreclosed assets. At September 30, 2011, management has evaluated the Bank's loan loss reserve and believes it is adequate based on the quality of the current loan portfolio. The increase in one-to-four-family real estate mortgage loans classified as substandard was the cause for the shift of a portion of the allowance from unallocated to allocated to one-to-four-family residential real estate mortgage loans in the allowance for loan losses. At September 30, 2011, there were no other assets that are not disclosed as classified or special mention, where known information about possible credit problems of borrowers caused us to have serious doubts as to the ability of the borrowers to comply with the present loan repayment terms and which may result in impairment or disclosure of such loans in the future.

Average balances and yields. The following tables set forth average balance sheets, average yields and costs, and certain other information at and for the periods indicated. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances, where applicable, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees, discounts and premiums that are amortized or accreted to interest income. Yields have been annualized.



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For the Three months Ended September 30,

	Average Balance	2011 Interest Income/Expense	Yield/ Cost (Dollars in thousands)		Average Balance	2010 Interest Income/Expense	Yield/ Cost	
Interest-earning assets:								
Loans	\$120,912	\$ 1,555	5.14	%	\$117,871	\$ 1,614	5.48	%
Securities - taxable	40,357	219	2.17		49,769	285	2.29	
Mortgage-backed securities	33,002	195	2.36		28,493	218	3.06	
Securities - tax exempt (1)	2,693	21	3.12		433	4	3.70	
Other	5,872	2	0.14		13,088	7	0.21	
Total interest-earning assets	202,836	1,992	3.93	%	209,654	2,128	4.06	
Non-interest-earning assets	8,847				8,530			
Total assets	\$211,683				\$218,184			
Interest-bearing liabilities:								
NOW accounts	\$13,245	12	0.36	%	\$10,301	14	0.54	%
Passbook savings	23,696	18	0.30		27,292	45	0.66	
Money market savings	25,537	30	0.47		27,185	57	0.84	
Individual retirement accounts	18,520	101	2.18		18,172	121	2.66	
Certificates of deposit	77,389	295	1.52		76,535	353	1.84	
Borrowings	24,745	223	3.60		29,533	293	3.97	
Total interest-bearing liabilities	183,132	679	1.48	%	189,018	883	1.87	%
Non-interest-bearing liabilities:								
Demand deposits	4,156				4,166			
Other	3,634				4,174			
Total liabilities	190,922				197,358			
Stockholders' equity	20,761				20,826			
Total liabilities and stockholders' equity	\$211,683				\$218,184			
Net interest income		\$ 1,313				\$ 1,245		
Interest rate spread (2)			2.45	%			2.19	%
Net interest-earning assets (3)	\$19,704				\$20,636			
Net interest margin (4)		2.59	%			2.38	%	
Average interest-earning assets to average interest-bearing liabilities	111	%			111	%		

(1) Tax-exempt interest income is presented on a tax equivalent basis using a 34 percent federal tax rate.

(2) Interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.

(3) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.

- (4) Net interest margin represents net interest income divided by total interest-earning assets.

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	For the Nine months Ended September 30,						
	Average Balance	2011 Interest Income/Expense	Yield/ Cost		Average Balance	2010 Interest Income/Expense	Yield/ Cost
(Dollars in thousands)							
Interest-earning assets:							
Loans	\$117,813	\$ 4,599	5.20	%	\$116,049	\$ 4,809	5.53 %
Securities - taxable	42,944	726	2.25		55,042	1,124	2.72
Mortgage-backed securities	33,711	650	2.57		26,481	634	3.19
Securities - tax exempt (1)	2,478	58	3.12		146	3	3.65
Other	5,985	6	0.13		10,611	12	0.15
Total interest-earning assets	202,931	6,039	3.97	%	208,329	6,582	4.21 %
Non-interest-earning assets	8,632				8,979		
Total assets	\$211,563				\$217,308		
Interest-bearing liabilities:							
NOW accounts	\$12,169	33	0.36	%	\$10,074	48	0.64 %
Passbook savings	24,344	65	0.36		26,900	169	0.84
Money market savings	26,706	113	0.56		25,380	189	0.99
Individual retirement accounts	18,491	315	2.27		18,235	393	2.87
Certificates of deposit	76,651	896	1.56		77,364	1,179	2.03
Borrowings	25,756	676	3.50		31,143	973	4.17
Total interest-bearing liabilities	184,117	2,098	1.52	%	189,096	2,951	2.08 %
Non-interest-bearing liabilities:							
Demand deposits	4,001				4,127		
Other	2,895				3,291		
Total liabilities	191,013				196,514		
Stockholders' equity	20,550				20,794		
Total liabilities and stockholders' equity	\$211,563				\$217,308		
Net interest income		\$ 3,941				\$ 3,631	
Interest rate spread (2)			2.45	%			2.13 %
Net interest-earning assets (3)	\$18,814				\$19,233		
Net interest margin (4)		2.59	%			2.32	%
Average interest-earning assets to average interest-bearing liabilities	110	%			110	%	

(1) Tax-exempt interest income is presented on a tax equivalent basis using a 34 percent federal tax rate.

(2) Interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.

- (3) Net interest-earning assets represent total interest-earning assets less total interest-bearing liabilities.
- (4) Net interest margin represents net interest income divided by total interest-earning assets.

## Comparison of Operating Results for the Three Months Ended September 30, 2011 and September 30, 2010

General. The Company had net income of \$26,000 for the quarter ended September 30, 2011 compared to net income of \$92,000 for the quarter ended September 30, 2010. Net income per basic and diluted share was \$0.02 for the quarter ended September 30, 2011 compared to net income per basic and diluted share of \$0.05 for the quarter ended September 30, 2010. The Company's net interest margin for the quarter ended September 30, 2011 increased 21 basis points to 2.59% from 2.38% for the quarter ended September 30, 2010, due to a decrease in the cost of our interest-bearing liabilities of 39 basis points from 1.87% to 1.48%, which was partially offset by a decrease in the yield on our interest-earning assets of 13 basis points from 4.06% to 3.93%.

The \$66,000 decrease in net income for the third quarter of 2011 compared to the third quarter of 2010 resulted from a \$147,000 increase in other expense and a \$16,000 decrease in other income, partially offset by a \$62,000 increase in net interest income, a \$34,000 decrease in income tax expense, and a \$1,000 decrease in provision for loan losses. The \$147,000 increase in other expense was mainly due to the increased investment in our loan origination division with additional salaries and employee benefits expense, occupancy, equipment, mortgage fees and taxes, and miscellaneous other operating expenses, partially offset by a reduction in our FDIC premium expense, resulting from changes made by the FDIC reflecting a lower rate in our deposit insurance assessment effective April 1, 2011 and applied beginning with the invoice payable on September 30, 2011. The \$16,000 decrease in other income was primarily due to a decrease in the realized gain on sale of loans, partially offset by an increase in fee income from Oakleaf Services, the Bank's wholly owned non-deposit investment services subsidiary, an increase in realized gain on sale of securities, and an increase in mortgage fee income. The \$62,000 increase in net interest income is reflective of the Company's ability to reduce its deposit and borrowing costs in a low interest rate environment, partly offset by a decrease in interest earning assets. The Company's lower effective tax rate for the third quarter of 2011 and 2010 resulted from a reduction in income tax expense due to the cash surrender value of our bank-owned life insurance and municipal bond interest income which are tax exempt for Federal income tax purposes.

Interest and Dividend Income. Interest and dividend income decreased by \$142,000, or 6.7%, to \$2.0 million for the three months ended September 30, 2011 from \$2.1 million for the three months ended September 30, 2010. The \$142,000 decrease in interest and dividend income resulted from an \$59,000, or 3.7%, decrease in interest income from loans, a \$66,000, or 23.2%, decrease in interest income from taxable securities, a \$23,000, or 10.6%, decrease in interest income from mortgage-backed securities, and a \$5,000, or 71.4%, decrease in interest income from other sources, mainly interest-earning deposits at the Federal Reserve Bank of New York and Federal Home Loan Bank of New York, partially offset by an \$11,000, or 366.7%, increase in interest income from tax exempt securities. Average interest-earning assets decreased by \$6.8 million, or 3.3%, to \$202.8 million for the three months ended September 30, 2011 from \$209.7 million for the three months ended September 30, 2010. The yield on interest-earning assets decreased by 13 basis points to 3.93% for the three months ended September 30, 2011 compared to 4.06% for the three months ended September 30, 2010. The overall decrease in interest and dividend income resulted from a decrease in yield on all interest earning asset categories, despite a volume increase in the higher yielding interest earning asset categories: loans, mortgage-backed securities, and tax exempt securities, for the three months ended September 30, 2011.

Interest Expense. Interest expense decreased \$204,000, or 23.1%, to \$679,000 for the three months ended September 30, 2011 from \$883,000 for the three months ended September 30, 2010. The decrease in interest expense resulted primarily from significantly lower average rates paid on deposits and borrowings and lower average balances on deposits and borrowings in the continuing low interest rate environment. The average balance of interest-bearing liabilities decreased \$5.9 million, or 3.1%, to \$183.1 million for the three months ended September 30, 2011 compared to \$189.0 million for the three months ended September 30, 2010. The average cost of interest-bearing liabilities decreased by 39 basis points to 1.48% for the three months ended September 30, 2011 from 1.87% for the three months ended September 30, 2010. The average cost of deposit accounts decreased by 33 basis points to 1.15%

for the three months ended September 30, 2011 compared to 1.48% for the three months ended September 30, 2010. The average cost of borrowings decreased by 37 basis points to 3.60% for the three months ended September 30, 2011 compared to 3.97% for the three months ended September 30, 2010. The average balance of borrowings decreased \$4.8 million, or 16.2%, to \$24.7 million for the three months ended September 30, 2011 compared to \$29.5 million for the three months ended September 30, 2010. The decrease in interest expense reflects the Bank's management of lower deposit and borrowing costs in a historically low interest rate environment. The Bank has continued to respond to the lower interest rate environment allowing for downward deposit re-pricing of all deposits accounts and borrowings decreasing our overall cost of funds.

At September 30, 2011, we had \$16.7 million of certificates of deposit, including IRAs, that will mature during the fourth quarter of 2011, with a weighted average cost of 1.25%. Based on current market rates, if these funds remain with the Bank with similar maturities, the rates paid on these deposits will decrease.

**Net Interest Income.** Net interest income increased \$62,000, or 5.0%, to \$1.3 million for the three months ended September 30, 2011 from \$1.2 million for the three months ended September 30, 2010. The increase in net interest income was due primarily to a lower average cost of deposits and borrowings, partially offset by a decrease in interest earning assets and decrease in yield on interest earning assets. The Company's net interest margin increased 21 basis points to 2.59% for the three months ended September 30, 2011 from 2.38% for the three months ended September 30, 2010.

**Provision for Loan Losses.** Based on management's evaluation of the factors that determine the level of the allowance for loan losses, we recorded \$7,000 in provision for loan losses for the three month period ended September 30, 2011 and \$8,000 for the three month period ended September 30, 2010. The allowance for loan losses as of September 30, 2011 was \$406,000, or 0.33%, of total loans, compared to \$381,000, or 0.33%, of total loans as of September 30, 2010. We ended the quarter with \$325,000 in one non-accrual loan at September 30, 2011 compared to \$23,000 in non-accrual loans at September 30, 2010. We recorded no charge offs in the third quarter of 2011 and 2010. We had no foreclosed real estate at September 30, 2011 or at September 30, 2010.

**Other Income.** Total other income decreased \$16,000, or 3.6%, to \$426,000 for the three months ended September 30, 2011 compared to \$442,000 for the three months ended September 30, 2010. In the three months ended September 30, 2011 compared to the three months ended September 30, 2010, there was a \$55,000 decrease in realized gain on sale of loans, a \$4,000 decrease in BOLI income, a \$7,000 decrease in miscellaneous other income, and a \$3,000 decrease in deposit service fees, partially offset by a \$16,000 increase in realized gain on sale of securities, a \$26,000 increase in commissions from Oakleaf Services insurance/annuity and security sales, and an \$11,000 increase in mortgage fee income.

**Other Expense.** Total other expense increased \$147,000, or 9.4%, to \$1.7 million for the three months ended September 30, 2011 compared to \$1.6 million for the three months ended September 30, 2010, primarily the result of additional expenses related to our three mortgage origination offices. The \$147,000 increase included an \$89,000 increase in salaries and employee benefits, a \$41,000 increase in occupancy expense, a \$33,000 increase in equipment expense, a \$32,000 increase in mortgage fees and taxes, a \$19,000 increase in miscellaneous other expenses, a \$6,000 increase in data processing costs, a \$5,000 increase in advertising expense, a \$2,000 increase in electronic banking, and a \$1,000 increase in directors fees, partially offset by an \$81,000 decrease in FDIC insurance premium expense. The significant decrease in FDIC premium expense resulted from recent changes made by the FDIC reflecting a lower rate in our deposit insurance assessment.

**Income Tax Expense.** We had pre-tax income of \$21,000 for the three months ended September 30, 2011 compared to pre-tax income of \$121,000 for the three months ended September 30, 2010, and had a \$5,000 tax benefit for the three months ended September 30, 2011, compared to a \$29,000 tax expense for the three months ended September 30, 2010, a decreases in tax expense of \$34,000. The effective tax benefit rate was (23.8)% for the three months ended September 30, 2011 compared to a tax expense rate of 24.0% for the three months ended September 30, 2010. The high effective tax benefit rate in the quarter ended September 30, 2011 was mainly the result of the benefit (reduction in tax expense) due to the increase in the cash surrender value of our bank owned life insurance and municipal bond interest income, which are tax exempt, as a percentage of taxable income. The lower effective tax rate in the quarter ended September 30, 2010 was a result of bank owned life insurance income and the utilization of New York State mortgage recording tax credits in the periods that had been previously subject to a valuation allowance. The New York State franchise tax recorded on taxable assets for the quarters ended September 30, 2011 and 2010 exceeded the mortgage tax generated in each of these periods.



## Comparison of Operating Results for the Nine months Ended September 30, 2011 and September 30, 2010

General. We had a net loss of \$4,000 for the nine months ended September 30, 2011 compared to net income of \$160,000 for the nine months ended September 30, 2010. The 164,000 decrease in net income for the first nine months of 2011 compared to the first nine months of 2010 was attributable to an increase in other expense of \$565,000 and an increase in provision for loan losses of \$8,000, partially offset by an increase in net interest income of \$290,000, an increase in other income of \$34,000, and an increase in income tax benefit of \$85,000. The net interest margin increased by 27 basis points to 2.59% for the nine months ended September 30, 2011 from 2.32% for the nine months ended September 30, 2010. The increase in the net interest margin reflects a decrease in the cost of our interest-bearing liabilities partially offset by the decrease in the yield on interest-earning assets for the nine months ended September 30, 2011 compared to September 30, 2010, together with a volume increase in higher yielding assets, mainly mortgage loans, mortgage-backed and tax exempt securities, replacing lower yielding assets, mainly interest earning deposits and taxable securities. The \$290,000 increase in net interest income was primarily due to the Company's ability to reduce interest-bearing liabilities costs at a quicker pace than interest-earning assets in a low interest rate environment. The \$565,000 increase in other expense was primarily due to additional expenses related to further expansion of our three mortgage origination offices that opened in January 2010 including additional salaries and employee benefits, occupancy, equipment, and other miscellaneous expenses, partially offset by a reduction in FDIC premium expense. The \$34,000 increase in other income was mainly due to increases in realized gain on sale of securities, an increase in mortgage fee income, an increase in Oakleaf revenue, and reduction of realized loss on sale of REO, partially offset by a decrease in deposit service fees, a decrease in realized gain on sale of loans, and a decrease in BOLI income. The \$85,000 decrease in the income tax expense resulted from a tax benefit (reduction in expense) due to the increase in the cash surrender value of our bank-owned life insurance and municipal bond interest income which are tax exempt for Federal income tax purposes.

Interest and Dividend Income. Interest and dividend income decreased by \$563,000, or 8.6%, to \$6.0 million for the nine months ended September 30, 2011 from \$6.6 million for the nine months ended September 30, 2010. The decrease in interest and dividend income resulted primarily from a \$398,000, or 35.4%, decrease in interest income from taxable securities, a \$210,000, or 4.4%, decrease in interest income from loans, and a \$6,000, or 50.0%, decrease in interest income from other sources, mainly interest-earning deposits at the Federal Reserve Bank and Federal Home Loan Bank, partially offset by a \$16,000, or 2.5%, increase in interest income from mortgage-backed securities, and a \$35,000, or 1166.7%, increase in interest income from tax exempt securities. Average interest-earning assets decreased by \$5.4 million, or 2.6%, to \$202.9 million for the nine months ended September 30, 2011 from \$208.3 million for the nine months ended September 30, 2010. The yield on interest earning assets decreased by 24 basis points to 3.97% for the nine months ended September 30, 2011 compared to 4.21% for the nine months ended September 30, 2010, reflecting decreases in interest yields on all interest earning asset categories.

Interest Expense. Interest expense decreased \$853,000, or 28.9%, to \$2.1 million for the nine months ended September 30, 2011 from \$3.0 million for the nine months ended September 30, 2010. The decrease in interest expense on interest-bearing liabilities resulted from lower average rates paid on deposits and borrowings and a decrease in the aggregate average balances. Average balances in interest bearing liabilities decreased \$5.0 million, or 2.6%, to \$184.1 million for the nine months ended September 30, 2011 compared to \$189.1 million for the nine months ended September 30, 2010. The average cost of interest-bearing liabilities decreased by 56 basis points to 1.52% for the nine months ended September 30, 2011 from 2.08% for the nine months ended September 30, 2010. The average cost of deposit accounts decreased by 47 basis points to 1.20% for the nine months ended September 30, 2011 compared to 1.67% for the nine months ended September 30, 2010. The average cost of borrowings decreased by 67 basis points to 3.50% for the nine months ended September 30, 2011 compared to 4.17% for the nine months ended September 30, 2010. The decrease in interest expense reflects a significantly lower cost of funds in total deposits and borrowings in a lower interest rate environment.





Net Interest Income. Net interest income increased \$290,000, or 8.0%, to \$3.9 million for the nine months ended September 30, 2011 from \$3.6 million for the nine months ended September 30, 2010. The increase in net interest income was primarily due to a decrease in the average cost of our interest-bearing liabilities of 56 basis points, while the average yield on our interest-earning assets decreased by 24 basis points. Our net interest margin increased by 27 basis points to 2.59% for the nine months ended September 30, 2011 from 2.32% for the nine months ended September 30, 2010. The increase in net interest margin was also attributable to the repositioning of the assets from shorter-term investments to long-term mortgages for the nine months ended September 30, 2011 compared to the nine months ended September 30, 2010.

Provision for Loan Losses. Based on management's evaluation of the factors that determine the level of the allowance for loan losses, we recorded a \$22,000 provision for loan losses for the nine month period ended September 30, 2011 compared to a \$14,000 provision for loan losses for the nine month period ended September 30, 2010. We continue to maintain exceptional credit quality within our loan portfolio with no charge-offs recorded within either reporting period. The allowance for loan losses at September 30, 2011 was \$406,000, or 0.33%, of total loans, compared to \$381,000, or 0.33%, of total loans at September 30, 2010. We had one non-accrual loan for \$325,000 at September 30, 2011 compared to one non-accrual loan for \$23,000 at September 30, 2010. We had no foreclosed real estate at September 30, 2011 or 2010.

Other Income. Other income increased \$34,000, or 3.9%, to \$897,000 for the nine months ended September 30, 2011 compared to \$863,000 for the nine months ended September 30, 2010. The \$34,000 increase was due to a \$48,000 increase in realized gain on sale of securities, a \$25,000 increase in mortgage fee income, a \$9,000 increase in commissions from Oakleaf Services insurance/annuity and security sales, and a \$5,000 reduction in foreclosed real estate losses, partially offset by a \$13,000 decrease in gain on sale of mortgage loans in the secondary market, a \$32,000 decrease in deposit service fees, and \$8,000 less in bank owned life insurance income.

Other Expenses. Other expenses increased \$565,000, or 13.2%, to \$4.9 million for the nine months ended September 30, 2011 compared to \$4.3 million for the nine months ended September 30, 2010. The increase was primarily the result of expenses related to our three mortgage origination offices which opened in January 2010. The \$565,000 increase resulted from a \$358,000 increase in salaries and employee benefits, a \$98,000 increase in occupancy expense, a \$66,000 increase in equipment expense, a \$45,000 increase in other expenses, a \$13,000 increase in directors fees, an \$11,000 increase in electronic banking, a \$12,000 increase in data processing costs, an \$8,000 increase in advertising, and a \$7,000 increase in mortgage fees and taxes, partially offset by a \$53,000 decrease in FDIC insurance premium expense.

Income Taxes. The Company had a pre-tax loss of \$63,000 for the nine months ended September 30, 2011 compared to pre-tax income of \$186,000 for the nine months ended September 30, 2010, and had a \$59,000 tax benefit for the nine months ended September 30, 2011, compared to a \$26,000 tax expense for the nine months ended September 30, 2010, a change of \$85,000. The effective tax benefit rate was (93.7)% for the nine months ended September 30, 2011 compared to an effective tax expense rate of 14.0% for the nine months ended September 30, 2010. The effective tax benefit for the nine months ended September 30, 2011 was primarily due to the increase in the cash surrender value of the bank owned life insurance and municipal bond interest income, which are tax exempt. The low effective tax expense for the nine months ended September 30, 2010 was the result of bank owned life insurance income and the utilization of New York State mortgage recording tax credits in the current period.

## Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments, advances from the FHLB, maturities and principal repayments of securities, and loan sales. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. Our asset/liability management committee is responsible for establishing and monitoring our liquidity targets and strategies in order to ensure that sufficient liquidity exists for meeting the borrowing needs and deposit withdrawals of our customers as well as unanticipated contingencies. We seek to maintain a liquidity ratio of 20.0% or greater. At September 30, 2011 our liquidity ratio was 55.0%. We believe that we have enough sources of liquidity to satisfy our short and long-term liquidity needs as of September 30, 2011.

We regularly adjust our investments in liquid assets based upon our assessment of:

- (i) expected loan demand;
- (ii) expected deposit flows;
- (iii) yields available on interest-earning deposits and securities; and
- (iv) the objectives of our asset/liability management program.

Excess liquid assets are invested generally in interest-earning deposits, short-term and intermediate-term securities and federal funds sold.

Our most liquid assets are cash and cash equivalents. The levels of these assets are dependent on our operating, financing, lending and investing activities during any given period. At September 30, 2011, cash and cash equivalents totaled \$11.8 million.

Our cash flows are derived from operating activities, investing activities and financing activities as reported in our Consolidated Statements of Cash Flows included in our Consolidated Financial Statements.

At September 30, 2011, we had \$9.1 million in loan commitments outstanding. In addition to commitments to originate loans, we had \$9.0 million in unused lines of credit to borrowers. Certificates of deposit, including IRAs comprised solely of certificates of deposits, due within one year of September 30, 2011 totaled \$62.4 million, or 65.4% of our certificates of deposit and 37.9% of total deposits. If these deposits do not remain with us, we will be required to seek other sources of funds including loan sales, other deposit products, including certificates of deposit, and FHLB advances. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before September 30, 2012. We believe, however, based on past experience that a significant portion of such deposits will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Our primary investing activity is, and will continue to be, originating loans. During the three months ended September 30, 2011, we originated \$13.6 million of loans.

Financing activities consist primarily of activity in deposit accounts and FHLB borrowings. We experienced a net increase in total deposits of \$2.1 million for the nine months ended September 30, 2011. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors, and by other factors.



Liquidity management is both a daily and long-term function of business management. If we require funds beyond our ability to generate them internally, borrowing agreements exist with the FHLB of New York, which provides an additional source of funds. FHLB borrowings decreased by \$2.5 million to \$24.2 million for the nine months ended September 30, 2011 compared to a net decrease of \$5.8 million to \$28.8 million for the nine months ended September 30, 2010. Historically, FHLB borrowings have primarily been used to fund loan demand and expand the investment portfolio. At September 30, 2011, we had the ability to borrow approximately \$82.6 million from the Federal Home Loan Bank, of which \$24.6 million had been advanced, gross of premium.

The Bank also has a repurchase agreement with a third party broker providing an additional \$10.0 million in liquidity. Funds obtained under the repurchase agreement are secured by the Bank's U.S. Government and agency obligations. There were no advances outstanding under the repurchase agreement at September 30, 2011 or at December 31, 2010.

The Bank is subject to various regulatory capital requirements, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At September 30, 2011, the Bank exceeded all regulatory capital requirements and was considered "well capitalized" under regulatory guidelines.

#### Off-Balance Sheet Arrangements

In the ordinary course of business, the Company is a party to credit-related financial instruments with off-balance sheet risk to meet the financing needs of our customers. These financial instruments include commitments to extend credit. We follow the same credit policies in making commitments as we do for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments to extend credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by us, is based on our credit evaluation of the customer.

At September 30, 2011 and 2010, we had \$9.1 million and \$9.6 million, respectively, of commitments to grant loans, and \$9.0 million and \$9.2 million, respectively, of unfunded commitments under lines of credit.

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable since the Company is a smaller reporting company.

#### Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at September 30, 2011.

There were no significant changes made in the Company's internal control over financial reporting or in other factors that could significantly affect the Company's internal control over financial reporting during the period covered by this report that have materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.



Part II – Other Information

Item 1. Legal Proceedings

The Company and its subsidiaries are subject to various legal actions arising in the normal course of business. In the opinion of management, the resolution of these legal actions is not expected to have a material adverse effect on the Company's consolidated financial condition or results of operations.

Item 1A. Risk Factors

Other than the information contained in this Quarterly Report on Form 10-Q, there are no material updates or additions to the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the Year Ended December 31, 2010 and Quarterly report on Form 10-Q for the quarter ended June 30, 2011, as filed with the Securities and Exchange Commission. Additional risks not presently known to us, or that we currently deem immaterial, may also adversely affect our business, financial condition or results of operations. Further, to the extent that any of the information contained in this Quarterly Report on Form 10-Q constitutes forward-looking statements, the risk factors also are cautionary statements identifying important factors that could cause our actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of us.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

- (a) There were no sales of unregistered securities during the period covered by this Report.
- (b) Not applicable.
- (c) There were no issuer repurchases of securities during the period covered by this Report.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. [Removed and Reserved]

Item 5. Other Information

None.

Item 6. Exhibits

The following exhibits are either filed as part of this report or are incorporated herein by reference:

- 3.1 Charter of FSB Community Bankshares, Inc.\*
- 3.2 Bylaws of FSB Community Bankshares, Inc.\*
- 4 Form of Common Stock Certificate of FSB Community Bankshares, Inc.\*
- 10.1 Supplemental Executive Retirement Plan\*
- 10.2 Form of Employee Stock Ownership Plan\*
- 10.3 Supplemental Executive Retirement Plan for K. Maroney\*\*
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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\* Filed as exhibits to the Company's Registration Statement on Form SB-2, and any amendments thereto, with the Securities and Exchange Commission (Registration No. 333-141380) on March 16, 2007.

\*\* Filed as an exhibit to the Company's Current Report on Form 8-K, file with the Securities and Exchange Commission on August 4, 2010.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 14, 2011

FSB COMMUNITY BANKSHARES, INC.  
/s/ Dana C. Gavenda  
Dana C. Gavenda  
President and Chief Executive Officer

Date: November 14, 2011

/s/ Kevin D. Maroney  
Kevin D. Maroney  
Executive Vice President and Chief  
Financial Officer